FOMC Briefing
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Clearly, the process of setting longer-run money targets is not getting any easier. Assessing the impact of changes in financial regulations and technology is a continuing problem. As a minor point, the recent DIDC decisions, for instance, complicate estimates of M2. Of more basic relevance at this time, the public's response to NOW accounts, and also to the sustained high level of short-term rates, has been in many ways unexpected, and leaves considerable uncertainty in its wake. There is uncertainty about when the shift to NOW accounts will be essentially completed. There will also be uncertainty about how to evaluate future behavior of the M1-B aggregate; its composition and presumably in some degree its behavior will differ from previous narrow money measures because it has a sizable component that pays explicit interest, that possibly may behave more like savings accounts, and that gives increased weight in the total to household's demands for transactions balances and liquidity. Then there is some uncertainty about what to make of the sharp rise in velocity of M1-B, particularly shift-adjusted, on average in the first half of this year. Does it indicate that a sustained period of downward shift in public preference for cash is in process? Or should it more be taken as evidence that the short-run relationship between narrow money and GNP is loosening further, given the wide variety of near substitutes for narrow money that has developed.

Judgments about these and similar issues affect the Committee's targets for 1981 and 1982. With regard to the shift-adjusted range for M1-B for 1981, the principal argument for lowering it would be a view that a sustained downward shift in demand for narrow money relative to GNP is in process and one which would produce for this year a shift noticeably larger than the 2½ percentage points assumed in staff GNP projections at the time this year's target was set in February, and which is also embodied in the staff's current projections. If there were such a larger shift, attempts to achieve the present 3½ to 6 percent target range would be more expansionary than the Committee originally bargained for.

The absence of a further downward shift of money demand in the staff's projection along with fairly strong continued growth in nominal GNP are why our interest rate projections for the balance of the year call for rather sustained high levels of rates. Unless GNP is considerably weaker than projected, we would expect a rebound in money demand, on the thought that the public has economized on cash this year by about as much as it can, or is willing, given existing financial technology, interest rates, and the learning curves of depositors and institutions. An expectation of such a rebound in money demand would argue for leaving the present shift adjusted M1-B range unchanged for 1981--and would suggest rather strong actual M-1B growth at some point over the next few months.

Keeping the present range unchanged does have certain problems. If the midpoint of the current range is attained by year-end, shift-adjusted M1-B will have grown by around a 10 percent annual rate over the next six months--though on a quarterly average basis this would work out as growth at about a 7½ percent annual rate from the second quarter to the fourth quarter of this year. Such a rapid growth might have an adverse impact on inflationary psychology, of course. On the other hand, aiming at much more moderate growth could place substantial further pressure on interest rates and the fabric of the financial system if staff estimates of money to GNP relationships are correct. One solution is for the Committee to accept or aim at a more moderate growth in M1-B over the next several months that brings growth for the year near the low end of the present target range, especially should that develop in an environment of stable or declining interest rates. If the Committee were to lean toward such an approach, and were at the same time to resist money growth in the 10 percent or higher area, this would not be inconsistent with some little lowering of this year's M1-B target range--or aiming in the low part of the present range.

As explained in the blue book, we still anticipate that the broader aggregates for 1981 will come in high relative to the announced ranges for them, particularly so if the midpoint for the M1-B growth range for the year is attained. Thus, the Committee may wish to consider whether or not to raise these ranges for the broader aggregates. However, the credibility of the Committee's will to continue monetary restraint might be called into question if the broader ranges were raised, especially in light of the increased attention given to broader aggregates because of uncertainties surrounding the interpretation of M1-B.

With regard to 1982, Mr. Chairman, perhaps just a few words are in order. There seems to be no need for the Committee at this time to declare whether the shift into NOW accounts will or will not be over by next year. If the Committee wishes to continue on the course of gradually reducing its growth ranges, it is probably simplest to consider taking at least another ½ point off the shift-adjusted M1-B range (the staff boldly suggests dropping M1-A). But because of uncertainties surrounding the behavior of M1-B, alluded to earlier, there is good reason to broaden the M1-B range from a 2½ percentage points width to a 3 percentage point width (an even wider range probably lacks credibility). Two logical alternatives if that approach were taken are ranges of 2½ to 5½ percent and 3 to 6 percent--advantages and disadvantages of which were noted in the blue book.

A lower range for M1-B next year does imply some further downward shift in narrow money demand as measured by our quarterly model money demand equation, given the 8½ percent increase in nominal GNP that we have projected for the year. In light of this year's experience, and our projection of continued historically high interest rates, which would provide somewhat more incentive than usual to economize on cash, that does not seem implausible. But if nominal GNP were projected, or targeted, to grow much more than 8½ percent in 1982, its consistency with a reduced target range for narrow money next year might well be called into question. (I might add--parenthetically--that if nominal GNP growth were unexpectedly weak next year, including with it a considerable deceleration of price increases and a sharp drop of interest rates, there is likely to be a substantial and probably one-time increase in the demand for narrow money as presently measured that the Committee would need to consider accommodating).

Ranges for the broader aggregates next year pose a problem similar to this year in that their projected growth, given M1-B, may be relatively high. But the problems would appear to be less pronounced than this year. The lower nominal GNP growth projected for next year will tend to hold down growth in the broader aggregates; moreover, we are not at this point projecting a substantial drop in market rates that would divert savings flows from market instruments to time deposits. Thus, there seem to be greater odds next year that broader money aggregates will fall within the ranges currently in place, though in the upper part. Indeed, on the basis of the projections presented in the blue book, it would not seem implausible to lower the 1982 range at least for M3 by ½ point from this year's range.

Finally, Mr. Chairman, I have not mentioned the problem of the ranges for actual M1-A and M1-B growth in 1981. You will recall that the M1-B range for 1981 thought consistent with the 3½ to 6 percent shift adjusted range was 6 to 8½ percent. The question arises whether that should be changed in view of unexpectedly rapid growth in OCDs over the first half of this year. Given the recent slowdown in OCD growth, it would not seem that much more than a ½ point increase in the range for actual M1-B is needed, as explained in the blue book. Indeed, the range could well be left unchanged in the thought that it is wide enough to encompass the likely result for the year, given the increase of only 6¾ percent at an annual rate in actual M1-B experienced over the first half of the year. It would appear more necessary technically to lower the range previously published actual range for M1-A. But all this becomes so complicated that the Committee may wish to consider simply abandoning the actual ranges and stick to the shift-adjusted ranges only.